

ICPS newsletter®

New legislation a mixed bag in 2003

Between December 2002 and December 2003, important changes took place in Ukraine's business regulation legislation, associated with the adoption of the Civil and Commercial Codes, reforms to tax and pension legislation, and changes to financial regulation. Given the standoff among different business and political groups, the adopted legislation continues to reflect compromises rather than clear and consistent state policy

A critical mass of gaps in legislation means that delays in adopting necessary laws and regulations could no longer be tolerated. So, between December 2002 and December 2003, a considerable number of crucial laws were passed. Still, laws based on political horse-trading are too often adopted without the detailed analysis and preparatory work necessary in elaborating and coordinating good policy. As a result, the number of contradictions among provisions in different pieces of Ukrainian legislation continues to grow. The ineffectiveness of laws as instruments of state policy is one of the fundamental problems with legislation in Ukraine.

Influential FIGs hamper property regulation

Corporate governance legislation saw few systemic changes during this period. For several years in a row, the Verkhovna Rada has failed to adopt a new Law on joint stock companies. Such a bill may not suit the interests of financial-industrial groups because it will deprive them of a slew of means for re-distributing property.

The reform of state property management and privatization legislation is being hampered for the same reason. Neither the Law on managing state-owned facilities nor the 2003-2008 State Privatization Program were adopted in 2003. In such circumstances and given the new provisions for state property management in the Civil Code, the exploitation of state-owned property could become totally beyond control in 2004.

Adopted on the same day, the Civil and Commercial Codes contain many incompatible means of regulating

identical matters. Still, it is clear that the regulation of property is gradually approaching market standards. Strengthened protection of the interests of property owners provided in the Civil Code reduces the risk of doing business.

Tax reform gets off the ground

Having understood the hopelessness of further work on the Tax Code, given the lack of effective cooperation between the Government and the legislature, lawmakers directed their efforts at reforming specific areas of tax legislation. They adopted a Law on individual income tax, lowered the corporate profit tax rate to 25% as of 2004, and further improved the tax administration system. In addition, pension legislation was reformed, broadening the base of contributors to the Pension Fund to include businesses paying under the simplified tax system. Unfortunately, lawmakers failed to determine the level of such contributions by the end of 2003, as a result of which the affected businesses were unable to budget their expenses for the following year.

In 2003, the Government clearly indicated its intention to either eliminate the simplified tax system or at least significantly restrict eligibility to use it. Specifically, as a result of changes to the Law on the 2003 State Budget, the special business license was abolished. But thanks to considerable efforts, small business managed to hang on to certain tax preferences for 2004. Most likely all the i's will be dotted in 2004, when a special law on simplified tax systems is adopted.

Active reform of tax legislation is substantially improving the business

environment in Ukraine. Still, the Government's efforts to maintain the current level of social spending will make it impossible to achieve the maximum effect from tax reform.

Financial markets gain incentives

In 2003, the financial sector gained new instruments to stimulate lending markets and the stock market. Also, the formation of the State Financial Services Markets Regulatory Commission was completed. This state body began to operate actively at the end of 2003, which had a positive impact on market players. In particular, it is likely that, once the Regulation on Credit Union Registration is adopted, the development of such unions will speed up.

Another positive step was the adoption of the Law on electronic documents and electronic document flow, and the Law on electronic digital signatures. The introduction of new forms of commerce should have a positive effect on the development of business in Ukraine and facilitate its integration into the world economy.

Conditions for trade unchanged

The new Commercial and Customs Codes, which regulate trade, have not introduced any revolutionary innovations in this area. Thus, there are unlikely to be substantial changes in the level of openness of foreign trade in 2004. As to the free movement of capital, this area has actually worsened. In particular, this was caused by NBU actions aimed at improving the process of capital inflows and outflows. However, this also had a positive consequence: capital flight slowed down.

Active efforts to bring Ukraine's legislation into compliance with WTO requirements resulted in the signing of 20 bilateral agreements on access to goods and services markets. At the same time, the overall process of concording

Ukrainian legislation to EU laws made little progress.

Business regulation inconsistent

Government and Verkhovna Rada activity in business regulation lacked a systematic approach in 2003. The most significant event was the adoption of the Law on state registration of enterprises and sole proprietors. The Law covers most of the gaps in the process of registering and shutting down commercial operations. Still, it fails to solve the problem of simplifying procedures for entering the market. The announced "one-stop shop" approach to registration will be impossible to institute without introducing a slew of changes to existing laws. Yet the Government has shown no intent to initiate such changes.

Government policy in the area of licensing continues to be discredited as the list of activities subject to licensing is changed without system and without forethought. The expansion of applications where holographic seals have to be used has simply increased unproductive business costs.

Changes in legislation intended to protect commercial competition were mostly geared towards increasing the role of the Anti-Monopoly Committee. This could result in more administrative pressure on businesses.

Judiciary remains weak

Though the State Judicial Administration, the body established to support the activity of the courts, has been operating since 2003, when the President approved the Regulation governing it, the situation has not much improved. The amount of Budget financing allocated to the judiciary continues to be miserly and its Administration remains dependent on both the Cabinet and the President.

Changes in the Commercial Procedural Code expanded the options for businesses to appeal decisions of the Higher Commercial Court. On the whole, however, procedural legislation is being reformed at a slow pace. The Administrative Procedural Code is still in the process of being drafted. Hold-ups in the adoption of this document could soon have a negative impact on the effectiveness of the newly-created administrative courts.

Making laws more effective

To at least partly improve the effectiveness of laws as instruments of state policy, the already-adopted Law on principles of state regulatory policy in commercial activity may prove helpful. This law places responsibility for planning regulatory activity, analyzing the impact of regulations, tracking the effectiveness of existing ones, and reviewing and cancelling ineffective ones, with those government bodies that develop and approve normative and legislative acts. Provided that these state authorities treat this responsibility as more than just a nominal one, the level of predictability, consistency and effectiveness of Ukrainian legislation should rise.■

*ICPS has been following changes in economic legislation since 1998. A detailed analysis of changes is presented in a series of publications called "New economic legislation," published within the framework of the publication **policy studies**. To receive ICPS publications, please contact Maksym Korepanov by phone at +380-44-236-5464 or by e-mail at marketing@icps.kiev.ua*

Table 1. Summary of changes in commercial legislation, December 2002 – December 2003

| Changes that stimulate business activity | Changes that hamper business activity |
|--|---|
| Reducing the tax burden on enterprises by adopting: <ul style="list-style-type: none"> • the Law on personal income tax; • the Law introducing changes to the Law on corporate profit tax (which lowered the tax rate and raised depreciation rates) | Failing during the course of the year to solve problems behind the accumulation of VAT refund arrears; adopting a decision to handle this debt by issuing T-bills |
| Eliminating flaws in tax administration | Spoiling the simplified tax system (cancelling special business licenses, attempting to raise the single and flat tax rates, obligating payers of the simplified tax to contribute to the Pension Fund) |
| Adopting a new version of the Civil Code, which will ensure more effective protection of property rights | Moving further away from the principles of state licensing policy and introducing considerable changes to the list of activities subject to licensing |
| Adopting the Law on principles of state regulatory policy in commercial activity, which should ensure an improved regulatory environment | Delaying reform of the judiciary, which deprives enterprises of the possibility to effectively defend their rights |
| Expanding the range of instruments available to the stock market through the Laws on mortgages and on non-state pension funds | Delaying the adoption of the Law on joint stock companies |
| Introducing new forms of lending through the Law on mortgage lending, operations with consolidated mortgages and mortgage certificates | Failing to pass a state privatization program, delaying the adoption of the Law on state property management, which makes state ownership untransparent |
| Adopting laws that regulate the flow of electronic documents | Allowing inconsistencies in many crucial provisions in the new Civil and Commercial Codes |

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To be included in the distribution list, mail your request to: marketing@icps.kiev.ua.

icps newsletter editor: Yevhen Shulha (shulha@icps.kiev.ua)

Phone: +380-44-236-4477, Fax +380-44-236-4668

English text editor: L.A. Wolanskyj.

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Address: 13a Pymonenka Street, Kyiv 04050, Ukraine

Web-site: <http://www.icps.kiev.ua>